

REPORT OF THE
OFFICE OF THE AUDITOR GENERAL

250.2

REVIEW OF THE OPERATIONS
OF THE SAN FRANCISCO PORT COMMISSION

APRIL 1975

TO THE
JOINT LEGISLATIVE AUDIT COMMITTEE

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ROOM 4126, STATE CAPITOL
SACRAMENTO, CALIFORNIA 95814
(916) 445-6161

April 3, 1975

The Honorable Speaker of the Assembly
The Honorable President pro Tempore of
the Senate
The Honorable Members of the Senate and the
Assembly of the Legislature of California

Members of the Legislature:

I am today releasing the report of the Auditor General on the operations of the San Francisco Port Commission requested by Assemblyman John Foran. The Auditor General's report on the Port's immediate and long-term projected cash deficits was issued in December 1974.

The San Francisco Port Commission was created upon the transfer of the Port from the state to the City and County of San Francisco on February 6, 1969. For the first time in its history, the 1975-76 proposed budget of the Port reflects the need for ad valorem tax support.

The Auditor General's report has cited the following deficiencies:

- Federal grant funds available to finance construction of planned pier projects have not been effectively pursued.
- The Port has consistently overestimated revenues in its budgets submitted to the Mayor and the Board of Supervisors.
- Previously budgeted capital improvement projects have been deferred in order to prevent the Port from requiring ad valorem tax support.

The Honorable Members of the Legislature
of California

April 3, 1975

Page 2

- The negotiation of long-term leases with Port tenants at fixed rental rates has not been in the best interests of the Port.

Some of the reasons found by the Auditor General's staff for the problems noted above are as follows:

- The San Francisco Port Commission has not committed local matching funds necessary to qualify for grant funds from the federal Regional Economic Development Assistance Office. Available 1971 bond fund monies could be used for this purpose.
- Since fiscal year 1970-71, the San Francisco Port Commission has ineffectively managed its budget and has provided the Mayor and the Board of Supervisors with unrealistic budget information. Between fiscal years 1970-71 and 1973-74, estimated revenues have exceeded actual revenues by \$8.2 million.
- 66-year leases have been negotiated with 10 of the Port's tenants at Fisherman's Wharf without provisions to adjust the rental rates until 1995. For illustrative purposes only, since justifiable differences in rental rates may exist from site to site, if these 10 tenants had been charged the same rental rates charged to the Port's tenants outside the Fisherman's Wharf area, the Port would have received additional estimated revenues of \$3.6 million over the next 20 years.

The Auditor General makes the following recommendations for action by the San Francisco Port Commission:

- Commit the \$18.4 million in available 1971 bond funds as the local matching funds necessary in order to obtain an additional \$18.4 million of grant funds from the federal Regional Economic Development Assistance Office.
- Submit new grant applications for obtaining such federal assistance, specifying the Port's presently planned pier projects as the construction projects to be approved.

The Honorable Members of the Legislature
of California
April 3, 1975
Page 3

- Make realistic revenue estimates which will adequately fund the Port's budgeted expenditures, without resorting to deferrals of capital improvement projects to offset revenue deficiencies. If needed expenditures cannot be realistically financed from Port revenues, the Commission should request other financial support, including ad valorem tax support if necessary, from the Mayor and the Board of Supervisors.
- Include a provision in all future leases with Port tenants to assure the flexibility to adjust rental rates at least once every five years on the basis of current economic conditions.

In a response contained in the Auditor General's report, the Port Director stated, among other things, that there has been a reluctance nationwide to accept federal funds for construction projects, and that the most recently negotiated leases have five-year renegotiation provisions.

Respectfully submitted,



BOB WILSON, Chairman
Jt. Legislative Audit Committee

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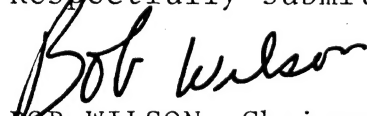
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Page 3

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Respectfully submitted,



BOB WILSON, Chairman
Jt. Legislative Audit Committee



STATE OF CALIFORNIA

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April 1, 1975

Honorable Bob Wilson
Chairman, and Members of the
Joint Legislative Audit Committee
Room 4126, State Capitol
Sacramento, California 95814

Dear Mr. Chairman and Members:

Transmitted herewith is our report on the operations of the San Francisco Port Commission. We issued an interim report pertaining to the Port's immediate and long-term projected cash deficits in December, 1974.

Respectfully submitted,

Harvey M. Rose
Auditor General

Staff: Glenn H. Merritt
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TABLE OF CONTENTS

	<u>Page</u>
INTRODUCTION	1
FINDINGS	
The San Francisco Port Commission has not effectively pursued federal grant funds to finance construction of planned pier projects.	2
Recommendations	5
Since fiscal year 1970-71, the San Francisco Port Commission has ineffectively managed its budget and has provided the Mayor and the Board of Supervisors of the City and County of San Francisco with unrealistic budget information. Between fiscal years 1970-71 and 1973-74, estimated revenues have exceeded actual revenues by \$8.2 million and funds budgeted but not expended for capital improvement have been needed to prevent the Port from requiring ad valorem tax support.	6
Recommendation	8
In 1970, the San Francisco Port Commission negotiated 66-year leases with 10 tenants at Fisherman's Wharf without provisions to adjust the rental rates until 1995. The best interests of the Port have not been served by negotiating such long-term leases without the ability to periodically adjust rental rates on the basis of current economic conditions.	10
Recommendation	12
OTHER PERTINENT INFORMATION	14
SUMMARY OF COMMENTS OF THE PORT DIRECTOR AND HIS STAFF	17

INTRODUCTION

In response to a legislative request, we have reviewed the operations of the San Francisco Port Commission, which was transferred from the State of California to the City and County of San Francisco on February 6, 1969.

An interim report pertaining to the Port's immediate and long-term projected cash deficits was issued by our office in December 1974.

Port policy is established by the San Francisco Port Commission, consisting of five persons appointed by the Mayor subject to confirmation by the Board of Supervisors, for terms of four years each. The Port Director, as the chief executive of the Port, is responsible for the Port's administrative activities. The current Port Director assumed his responsibilities on February 14, 1975.

For the first time since the Port was transferred from the state, the San Francisco Port Commission's proposed budget for fiscal year 1975-76 reflects the need for ad valorem tax support.

The Grand Jury and personnel of the City and County of San Francisco, including the Budget Analyst of the Board of Supervisors, have cooperated with us fully during the course of our audit.

FINDINGS

THE SAN FRANCISCO PORT COMMISSION HAS NOT
EFFECTIVELY PURSUED FEDERAL GRANT FUNDS TO
FINANCE CONSTRUCTION OF PLANNED PIER PROJECTS.

In order to receive federal Economic Development Assistance the following steps are necessary: (1) the local government must be declared eligible by the federal Department of Commerce, (2) local matching funds must be provided and (3) a determination made that the proposed projects have merit.

In 1969 the initial steps were taken that resulted in San Francisco being declared eligible for federal Economic Development Assistance in 1971. At that time, the Port was requested to submit both grant applications and a supporting resolution by the Port Commission. Applications were submitted but the Commission did not pass the necessary resolution.

In 1972, the Port Commission adopted a resolution to seek federal grant fund assistance; however, the resolution specified that the Port was not yet committed to provide matching funds. The grant applications, which total \$42.9 million, state that the necessary local matching funds could be provided by a bond issue, if approved by the voters. On the basis of the data contained in the project applications and in the Commission's resolution, both the local Overall Economic Development Planning Group which establishes priorities for the Mayor's Office and the federal Regional Economic Development Assistance Office have concluded that the necessary matching funds have not been committed.

Depending on the findings of the federal Regional Economic Development Assistance Office, from 50 percent up to 80 percent of approved project costs are paid by federal funds. The San Francisco Regional Economic Development Assistance Office has determined, based on unemployment statistics, that San Francisco currently qualifies for 50 percent federal matching funds.

The receipt of federal funds by the City depends initially upon the availability of federal funds under the Economic Development Assistance Act. Once funds are available under the Act, whether or not the City would receive funds depends upon the Regional Economic Development Assistance Office determining that specific projects submitted qualify for federal assistance. The final variable is the amount of local funds available for matching.

As discussed earlier, the Port's prior grant applications were not considered because local matching funds were not committed.

The use of one logical source of local funds for matching purposes has not been pursued by the Port.

In 1971, San Francisco voters approved a \$34 million general obligation bond issue for improving San Francisco Harbor and its facilities. Of the total \$34 million, \$20 million has been issued and of that amount, \$9.2 million has been expended as of December 31, 1974. It is estimated that of the remaining

unexpended \$10.8 million available, \$6.4 million is necessary to complete work in process. The balance, or \$4.4 million, together with the funds which would be provided if the \$14 million in unissued bonds were sold, would total \$18.4 million and, if available to match federal funds to construct the Port's presently planned pier projects, would result in the receipt of federal grant monies amounting to \$18.4 million if the federal government paid for 50 percent of the construction costs.

We recognize that, depending upon the language of the authorization of the issuance of the bonds and the language of the bonds themselves, a legal problem may exist over the use of the bond fund proceeds to obtain additional federal funds, even if the combined local and federal funds resulting were used for the same purpose as the bonds were originally authorized and sold. However, an examination of the voter's pamphlet and the bond resolution by the Chief Counsel of the Office of the Auditor General discloses no prohibition to such use as long as the bond proceeds are ultimately spent for the purposes for which the bonds were issued. Such purposes are harbor improvements. On that basis, we conclude that every attempt should be made to use the bond money as local matching funds to obtain additional federal funds for harbor improvement purposes.

CONCLUSION

Although funds are available, the San Francisco Port Commission has not made the commitment necessary to qualify for financial assistance from the federal Regional Economic Development Assistance Office.

RECOMMENDATIONS

We recommend that in order to effectively secure federal grant funds, the San Francisco Port Commission commit the \$18.4 million of total available 1971 bond funds as the required local matching funds necessary to obtain \$18.4 million of federal grant assistance from the federal Regional Economic Development Assistance Office, or any portion thereof which is available.

We further recommend that the Port Commission submit new grant applications for obtaining federal Economic Development Assistance funds, specifying the Port's presently planned pier projects as the construction projects to be approved.

BENEFITS

Implementation of these recommendations could result in the Port receiving \$18.4 million in federal grant funds for harbor improvement purposes.

SINCE FISCAL YEAR 1970-71, THE SAN FRANCISCO PORT COMMISSION HAS INEFFECTIVELY MANAGED ITS BUDGET AND HAS PROVIDED THE MAYOR AND THE BOARD OF SUPERVISORS OF THE CITY AND COUNTY OF SAN FRANCISCO WITH UNREALISTIC BUDGET INFORMATION. BETWEEN FISCAL YEARS 1970-71 AND 1973-74, ESTIMATED REVENUES HAVE EXCEEDED ACTUAL REVENUES BY \$8.2 MILLION AND FUNDS BUDGETED BUT NOT EXPENDED FOR CAPITAL IMPROVEMENT HAVE BEEN NEEDED TO PREVENT THE PORT FROM REQUIRING AD VALOREM TAX SUPPORT.

Since the transfer of the Port from the state to the City and County of San Francisco, budgeted expenditures have consistently exceeded actual revenues, and the Port has consistently overestimated revenues in its budgets submitted to the Mayor and the Board of Supervisors. Balanced budgets have been presented and approved in which estimated revenues have been overly optimistic. Excesses of budgeted expenditures over actual revenues has resulted in the deferral of previously appropriated capital improvement projects, as well as in the necessity of using the surplus which was transferred by the state to the City and County of San Francisco.

On February 6, 1969 when the San Francisco Port Authority was transferred to the City and County of San Francisco, the Port had an unappropriated surplus of \$8,700,900. Extraordinary income received increased this balance to \$10,320,000 on June 30, 1969.

During the 1969-70 fiscal year, \$7,300,000 of these funds were committed to capital improvement projects and over \$2 million was used to fund the budgeted deficit of the Port for that fiscal year. The balance of the unappropriated surplus at June 30, 1970 was \$430,000.

In each of the succeeding fiscal years, 1970-71 through 1973-74, the Port Commission overestimated actual revenues and approved budgeted expenditures which exceeded actual revenues. These expenditures included operating expenses and capital improvements. Budgeted capital improvements are not required to be expended in the fiscal year in which the funds are budgeted. Therefore, to determine the relationship between budgeted and actual expenditures for capital improvements would require detailed analyses of each approved project over a number of years. It was not feasible to undertake detailed analyses of this magnitude during the time frame of this review.

However, it is evident from a review of the accounting records maintained by the Port Commission and by the Controller of the City and County of San Francisco, that total budgeted expenditures have exceeded actual revenues. Because actual revenues have been less than estimated, the Port has not expended funds for various capital improvements authorized in prior fiscal years. The following schedule shows various expenditure and revenue data.

Fiscal Year	Original Budgeted Expenditures*	Estimated Revenues*	Actual Revenues	Excess Of Estimated Revenues Over Actual Revenues	Excess Of Budgeted Expenditures Over Actual Revenues
1970-71	\$13,740,000	\$13,750,000	\$11,700,000	\$2,050,000	\$2,040,000
1971-72	14,500,000	14,700,000	11,100,000	3,600,000	3,400,000
1972-73	13,740,000	14,400,000	13,500,000	900,000	240,000
1973-74	<u>15,290,000</u>	<u>16,400,000</u>	<u>14,700,000</u>	<u>1,700,000</u>	<u>590,000</u>
Totals	<u>\$57,270,000</u>	<u>\$59,250,000</u>	<u>\$51,000,000</u>	<u>\$8,250,000</u>	<u>\$6,270,000</u>

*Approved by the Mayor and the Board of Supervisors

Based on the Port's own projections, revenue estimates are overstated for the 1974-75 current fiscal year by \$1 million. In our judgment, this is a conservative projection and the overstatement will be greater when revenue adjustments are made for accounts receivable.

So long as the cash surplus transferred from the state was not completely exhausted, operations have continued without outside financial assistance. The nonfunding of previously budgeted capital improvement projects, together with the use of the surplus funds transferred from the state, offsets the fact that actual revenues have been consistently less than estimated revenues.

As reported in our December 1974 interim report on projected cash deficits, we projected that the Port will have a cash deficit at June 30, 1975.

CONCLUSION

The San Francisco Port Commission has ineffectively managed its budget and has provided the Mayor and the Board of Supervisors with unrealistic budget information.

RECOMMENDATION

We recommend that the San Francisco Port Commission make realistic revenue estimates which will adequately fund the Port's budgeted expenditures, without resorting

to deferrals of capital improvement projects to offset revenue deficiencies. If needed expenditures cannot be realistically financed from Port revenues, the Commission should request other financial assistance, including ad valorem tax support if necessary, from the Mayor and the Board of Supervisors.

BENEFITS

Proper implementation of this recommendation will assure the Port of a more effectively managed and realistic budget.

IN 1970, THE SAN FRANCISCO PORT COMMISSION NEGOTIATED 66-YEAR LEASES WITH 10 TENANTS AT FISHERMAN'S WHARF WITHOUT PROVISIONS TO ADJUST THE RENTAL RATES UNTIL 1995. THE BEST INTERESTS OF THE PORT HAVE NOT BEEN SERVED BY NEGOTIATING SUCH LONG-TERM LEASES WITHOUT THE ABILITY TO PERIODICALLY ADJUST RENTAL RATES ON THE BASIS OF CURRENT ECONOMIC CONDITIONS.

Since the San Francisco Port was transferred to the City and County of San Francisco in February 1969, long-term leases have been negotiated with tenants at Fisherman's Wharf.

Prior to 1970, restaurants at Fisherman's Wharf were on a month-to-month rental basis. The rent charged was specified as percentages of gross sales and periodically these percentages were revised.

In 1970, long-term leases were negotiated with these 10 tenants. The leases are for 66 years and the amounts of rents paid are percentages of gross sales. There are no provisions in the contracts to renegotiate these percentages prior to 25 years, or until 1995. The current rental rates, which are fixed through 1995, are five percent on food sales and 6.5 percent on liquor and other sales. The current effective percentage rate for these tenants is 5.5 percent of all sales.

The 1969 minutes of the meetings of the Port Commission at the time that these leases were negotiated indicate that the Commission was unsure as to what the appropriate rental rates should be. On the other hand, the minutes of the Commission meetings are not clear as to the basis for the rates finally adopted. Nevertheless, the Commission entered into leases which not only established percentages but precluded renegotiation of those percentages for 25 years.

The most current percentage rents charged by the Port to tenants outside the Fisherman's Wharf area are six percent on food sales and eight percent on liquor and other sales which results in an estimated effective rate of 6.5 percent of all sales.

The following table compares actual revenue received from the 10 tenants at Fisherman's Wharf during the 1974 calendar year and the estimated revenues which will be received over the next 20 years of the leases before the rates can be renegotiated, to the revenues which could be received during the same period if rental rates were the same as those charged to other Port tenants outside the Fisherman's Wharf area. We recognize that justifiable differences in rental rates may exist from site to site. We further recognize that assuming the most current rents charged outside the Fisherman's Wharf area are appropriate that such rates may not be reasonable for all Fisherman's Wharf tenants. However, even if the rates charged at the most recent leases outside of Fisherman's Wharf should be charged to Fisherman's Wharf tenants, the terms of the leases preclude such rates until 1995. The following table is intended to illustrate the magnitude in the different rates and its impact on Port revenues.

	<u>Rental Revenue Under Current Effective Rate Of 5.5% From Tenants At Fisherman's Wharf</u>	<u>Estimated Revenue Under Effective Rate of 6.5% From Tenants Outside The Fisherman's Wharf Area</u>	<u>Difference</u>
Annually	\$ 834,000	\$ 1,017,000	\$ 183,000
Remaining life of leases before rental rates can be renegoti- ated (20 years)	\$16,680,000	\$20,340,000	\$3,660,000

CONCLUSION

The fact that rental rates contained in leases between the San Francisco Port Commission and tenants at Fisherman's Wharf cannot be renegotiated until 1995 is not in the best interests of the Port.

RECOMMENDATION

We recommend that the San Francisco Port Commission include a provision in all future leases with Port tenants to assure the flexibility to adjust rental rates at least once every five years on the basis of current economic conditions.

BENEFITS

Proper implementation of this recommendation should result in fair and equitable rentals charged to and paid by Port tenants.

OTHER PERTINENT INFORMATION

Leasing Policies and Procedures

The San Francisco Port Commission has not adopted a formal policy for leasing Port properties. Consequently, the property rental department of the Port is still operating under procedures informally initiated by previous commissions.

In the few instances that the Port has competitively bid leases, it has been subject to criticism due to the absence of defined leasing and bidding procedures. The Port's commercial property consultant has developed leasing policies and procedures for Commission approval. As of March 28, 1975, the Commission had not adopted any formal leasing policies and procedures.

Accounting Department

The Accounting Department of the Port is understaffed. As a result, they have had to utilize staff from other departments of the Port to perform needed financial functions.

Even with this additional staff, the department is still behind in the maintaining of financial records and the auditing of the Port's tenants. In addition, we conclude that additional useful financial analysis could be provided to the Port's management.

Other Conditions Affecting Operations

For the five years since the Port was transferred from the state to the City and County of San Francisco, the net income from operations was \$2.9 million, or \$4.8 million less than was realized during the last five years of state administration. We estimate that a major part, approximately \$3 million, of this reduction in net income could have been avoided if the Port's older finger piers had been converted to other uses, such as housing and restaurants, as was planned. Delays have been caused by the absence of concurrence as to whether facilities were surplus to maritime needs and objections to the planned alternative usage. Because of these delays, the options for the long-term future use of these facilities are still available.

Other factors which have contributed to the reduced net income are: (1) a reduction in the amount of cargo handled, (2) an increase in the rate of inflation, and (3) the cost of Port services to retain Port tenants and other users.

Fixed Minimum Rents

So that the Port will realize the highest assured income, the commercial property consultant to the Commission is attempting to obtain in all future leases fixed minimum rentals equal to 75 percent of the prior rental income based on a percentage of gross sales. The tenants at Fisherman's Wharf are currently paying fixed minimum rentals that range from only 5.6 percent up to 40 percent of the annual estimated rental income based on a percentage of gross sales.

Based on 1974 percentage rental receipts from these tenants, the additional rent guaranteed to the Port would be \$32,500,000 over the remaining life of the leases if the fixed minimum rents were periodically adjusted to 75 percent of the prior rental income based on a percentage of gross sales.

SUMMARY OF COMMENTS OF
THE PORT DIRECTOR
AND HIS STAFF

1. Although federal funds may not have been effectively sought, it must be realized the Commission has had and continues to have a reluctance to rely upon tax money, whether federal, state or local for Port capital improvements. The reluctance to accept federal funds for construction has been nationwide.
2. We agree that budgeted revenues have been overestimated and that revenues and expenditures should be realistically stated.
3. The most recent leases negotiated by the Port have five-year renegotiation provisions.
4. We agree that the accounting department is understaffed but the primary reason is the salary levels are so low that we cannot get people.
5. A legal condition precedent to conversion of finger piers is that the Port declare the pier unnecessary for commerce and navigation. The Port has been reluctant to do so hastily.
6. We agree that minimum rents should be maximized.
7. The Commission stated at its January 28 meeting it was postponing consideration of the adoption of formal leasing policies and procedures until the new Port Director becomes familiar with the operations of the Port.